DOCKET NO. HHB-CV-21-6066325S

1st ALLIANCE LENDING, LLC	:	
	:	SUPERIOR COURT
Plaintiff	:	
	:	JUDICIAL DISTRICT OF
V.	:	NEW BRITAIN
	:	
CONNECTICUT DEPARTMENT OF BANKING and	:	AT NEW BRITAIN
JORGE PEREZ, Commissioner, Connecticut Department	:	
Of Banking	:	MARCH 8, 2023
	:	
Defendants	:	

1st ALLIANCE'S REPLY MEMORANDUM

TABLE OF CONTENTS

To demonstrate that the Commissioner's Order is arbitrary and capricious, one need look no further than Defendants' ongoing unwillingness to articulate where they believe the SAFE Act draws the line between licensable and non-licensable conduct.[1] From the start of the Department's audit in 2018 through the merits brief they filed in this appeal five years later, Defendants have refused to tell 1st Alliance, the Connecticut mortgage loan industry, or this Court what, specifically, they believe the SAFE Act prohibits and what it does not. Nothing can be more arbitrary and capricious, or a greater abuse of discretion, than a regulatory agency imposing a penalty for violation of a standard it refuses to articulate. "A fundamental principle in our legal system is that laws which regulate persons or entities must give fair notice of conduct that is forbidden or required." *F.C.C. v. Fox Television Stations, Inc.*, 567 U.S. 239, 253 (2012) (vacating regulatory penalty).

Here, two crucial legal questions underlie Defendants' five-year prosecution of 1st Alliance: (1) what is an "Application" for a Mortgage Loan in Connecticut, and (2) did 1st Alliance violate the Connecticut SAFE Act, § 36a-485 *et seq. See* 1st Alliance Administrative Appeal Memorandum [Dkt. 144.00] ("1A Mem.") at 1. Yet, as Defendants have done throughout this process, Defendants' Brief ("Def. Br.") all but ignores these legal questions. For example, in its appeal memorandum, 1st Alliance provided a detailed historical analysis of Connecticut's SAFE Act, and an explanation of what constitutes "taking an Application" under that Act. 1A Mem. at 2-5, 22-24. That statutory history demonstrates that the Connecticut legislature specifically ***removed*** from requiring licensure the types of activities in which 1st Alliance's HLCs engaged. *Id.* at 2-5.

[1] All capitalized terms are used as defined in 1st Alliance's Administrative Appeal Memorandum.

Defendants ignore 1st Alliance's analysis, and largely ignore the Connecticut SAFE Act altogether.[2] They instead cut and paste from the Order to restate the business practices of which the Commissioner disapproves. *See, e.g.*, Def. Br. at 11-15. But they fail to explain how those practices ***violate the SAFE Act***. As 1st Alliance has explained, particular information found only in a purchase and sale agreement is both customary and necessary under the SAFE Act for a lender to decide not only ***whether*** to make an offer of residential loan terms, but ***what*** terms to offer. 1A Mem. at 6-8, 11-14. 1st Alliance further explained that all "six pieces of information" must be gathered to constitute the "taking of an application" under TRID, the regulatory mechanism for disclosing residential mortgage loan terms to consumers. *Id*. at 2-5. But even in their appeal brief, Defendants refuse to explain ***their*** view of the SAFE Act's requirements, and where they believe the line lies between licensable and non-licensable activity. Given this refusal, the Commissioner's imposition of license revocation and a $750,000 fine was arbitrary and capricious (and unfair and unjust), especially given the Department's failure to present any evidence that consumers were harmed by any purported violation (*see* 1A Mem. at 30, 34, 48).

Beyond this fundamental shortcoming, Defendants' Brief fails throughout to address 1st Alliance's arguments, instead largely repeating and resting on the Commissioner's findings. Such responses, and the arguments that Defendants do raise, are unavailing.[3]

I. Defendants Ignore the Proper Standard

As a preliminary matter, Defendants ignore that most of the questions presented in this appeal are legal: what do the SAFE Act and other statutes at issue in these proceedings ***legally***

[2] Defendants also ignore 1st Alliance's argument that the federal SAFE Act does not apply here. *See* 1A Mem. at 5-6.

[3] For the sake of brevity and efficiency, 1st Alliance addresses only the most significant points raised in Defendants' Brief. Where 1st Alliance does not address a specific issue, it relies upon the arguments in its main appeal brief and at the upcoming oral argument and does not waive any such arguments.

require (entirely apart from Defendants' policy ***preferences***)? The Commissioner's factual findings may be entitled to some deference. *See, e.g.*, Def. Br. at 3-4, 28-29.[4] But the Commissioner's legal interpretations in the Order are ***not*** entitled to deference and are considered *de novo* by this Court. 1A Mem. at 1-2. Defendants do not argue otherwise.

II. Defendants' Arguments Regarding the SAFE Act Are Without Merit

A. Defendants Ignore the Law

As discussed above, Defendants ignore 1st Alliance's detailed statutory analysis of the Connecticut SAFE Act and refuse to explain where they view the dividing line to be between licensable and non-licensable activity. *See* 1A Mem. at 22-24. The closest Defendants come is when they imply that a person could be deemed to take an application if they collect ***any*** "information for the purpose of facilitating 1st Alliance's decision to offer a loan." Def. Br. at 33. But while collecting basic information such as a potential borrower's name or income may "facilitate" a loan decision, the gathering of such preliminary information is ***not*** all of the information "customary and necessary" for 1st Alliance as a mortgage lender to reach "a decision whether to make" an offer of residential mortgage loan terms. *See* 1A Br. at 6-8, 22-24. Defendants do not make clear whether they are asserting that the gathering of even such minimal information, standing alone, requires licensure under the Connecticut SAFE Act (which would be an extraordinary position and a huge surprise to the mortgage industry).[5]

[4] Even that deference has limits; for example, the Court must overturn any factual finding that is "clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record" or is "arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion." § 4-183(j).

[5] Defendants' argument that HLCs took applications because 1st Alliance had an ***automated*** system (outside of HLC control) that rejected potential borrowers who failed to meet certain threshold criteria (Def. Br. at 7-10, 33) is incorrect. *See* 1A Br. at 11 and n.12.

Defendants' refusal to articulate a standard has plagued these proceedings since their inception. On September 7, 2018, after the audit but before the Department commenced formal action, the Department emailed 1st Alliance to "share [a] previous multi-state Consent order issued by Connecticut among other states," presumably to demonstrate to 1st Alliance that at least one other company had signed a consent order for ostensibly similar (but in fact dissimilar) alleged misconduct. AR4519. However, the linked consent order gave no specifics as to the actual standard being imposed, beyond the type of conclusory declarations of wrongdoing that Defendants continue to make through the present day.[6]

Defendants point to a "non-exhaustive" list of scenarios from Appendix A to the federal Regulation H in support of its argument that the HLCs "took residential mortgage loan applications." Def. Br. at 31-33. But Defendants do not point to any Connecticut statute or regulation adopting Regulation H as the legal standard that the Department would enforce against mortgage lenders in Connecticut such as 1st Alliance. Moreover, even if Regulation H did apply here (and it does not), its requirements were not violated here. *See* 1A Mem. at 19-22.

Defendants' failure to articulate an actual legal standard raises critical due process concerns that are fatal to the Order. 1A Mem. at 46-50. The Commissioner ***revoked 1st Alliance's license*** and ***imposed a $750,000 fine*** based on his general policy preferences—not on the law. This violates not only Supreme Court and Second Circuit precedent (1A Mem. at 47), but also

[6] The link in the Department's September 7 email is no longer active, and the linked order appears not to be available on the Department's website. However, the consent order in question is available at https://www.mass.gov/doc/mortgage-access-corporation-dba-weichert-financial-services/download. That consent order simply recounts that unlicensed personnel (1) "negotiate[d] loan rates and terms with the applicant," without discussing what any of those terms mean in the context of the SAFE Act; (2) obtained credit reports, which is not licensable activity under the SAFE Act (*see* 1A Mem. at 20); (3) actually "complete[d]" 1003 Application Forms and submitted them to the automated AUS underwriter system, which even Defendants do not argue HLCs did here; and (4) locked interest rates for borrowers, which HLCs also did not do here (*see* 1A Mem. at 21, 22 and Part II.C. below). Notably, no similar multi-state enforcement action has ever been pursued against 1st Alliance.

common sense and fundamental fairness. Defendants essentially base their entire legal argument on their belief that a system that does not require licensure for a person who "collected all but one piece of the information necessary to complete a mortgage loan application" is "absurd." Def. Br. at 34. Defendants may disagree with 1st Alliance's business model as a policy matter, and they are free to seek change in the law or to issue regulations. But their preferences are not law, and 1st Alliance complied with the law. *See generally* 1A Mem. at 2-5, 9-18, 18-26.[7]

Defendants rely heavily on a 2017 audit report written by Briana Massey, who served as 1st Alliance's Chief Compliance Officer for a brief time. Massey's written report stated that HLCs were "engaging in what may constitute … licensed activity under the SAFE Act" and that such problems "systemic." *See, e.g.*, Def. Mem. at 21, 31, 36. However, Massey admitted both in her contemporaneous discussions with 1st Alliance management ***and in her sworn testimony in these proceedings*** that she had exaggerated the scope of the problem in her written report in order to call attention to her potential concerns. 1A Mem. at 32-33. She further admitted that in fact there were ***not*** systemic issues with HLC conduct. *Id.*[8]

Defendants seek to elevate Massey to an ultimate arbiter of the law. *See, e.g.*, Def. Mem. at 34. But Massey herself admitted that her interpretation of the SAFE act—which Defendants endorse and rely upon—could be incorrect. 1A Mem. at 32. She acknowledged that, at a minimum, there is "grey area" concerning what is licensable activity under the SAFE Act. *Id.* Massey personally felt that HLCs were getting too close to the line, and the company addressed

[7] 1st Alliance agrees with Defendants that a person can "take an application" within the meaning of the SAFE Act without being ultimately responsible for approving the loan. Def Mem. at 34. But to take an application, the person still has to actually ***take*** enough information for the purpose of deciding whether, and what, residential loan terms to offer within the legal meaning of the SAFE Act.

[8] The very existence of the internal audit is evidence that the company, contrary to the Order's conclusions, maintained an active program of supervision. *See also* Part III below.

her concerns by implementing many of her reform proposals. *Id.* at 33. But for all of the reasons discussed in 1st Alliance's appeal memorandum, Massey's (and the Commissioner's) legal interpretation is simply wrong.

B. Defendants Ignore the Facts

Although Defendants spend a substantial portion of their brief recounting the facts found by the Commissioner, they all but ignore the detailed timelines 1st Alliance prepared, which use data from the Byte logs and other documents in the record to show each significant processing step in each of the sixteen transactions highlighted by the Commissioner. *See* 1A Mem. at Exs. A1-16. Those timelines demonstrate that HLCs did not perform any licensable activity in any of those files. 1A Mem. at 9-18.

Defendants decline to address the substance of those timelines, and do not argue that the facts set forth therein are incorrect. Rather, they make a halfhearted argument that the timelines should be excluded as constituting new evidence that was unavailable to the hearing officer. Def. Br. at 3, 49-50. This argument is frivolous. There is no dispute that 1st Alliances' timelines are all based on Byte data logs and other documents that are fully admitted and in the record. There is nothing unusual or improper about a party creating demonstratives from admitted data to facilitate a Court's analysis and review. Nor can there be any dispute that 1st Alliance repeatedly urged the Department to consider the Byte logs before, at, and after the administrative hearing.[9]

[9] 1st Alliance first urged the Department to review the Byte logs during and after the Department's initial audit of the company in 2018, long before the administrative hearing that gave rise to the present appeal. 1A Br. at 43. But the Department consistently refused to consider them. *Id.* 1st Alliance then explained the significance of the logs to the Hearing Officer at the initial proceedings. AR6822-23, 6860-63. When this Court ordered the Commissioner to admit and consider additional logs that the hearing officer had excluded (*see* [Dkt. No. 108.10]), 1st Alliance provided detailed write-ups of the how the newly admitted logs disproved the Commissioner's findings, and explained that every transaction could be similarly analyzed. AR7180-82. 1st Alliance also offered to provide similar write-ups of the remaining Byte logs in the record at the Hearing Officer's request. AR7187-88. Yet the Commissioner continued to refuse to substantively engage with the Byte logs in his Supplemental Decision and Order. AR7199-7203.

The timelines demonstrate that all substantive decisions related to each of the sixteen files highlighted by the Commissioner were made by the MLO assigned to the loan. *See* 1A Mem. at 9-18 and Exs. A1-16. HLCs would sometimes ***convey*** the outcome of the MLO's work to the borrower, or gather documentation from the borrower on behalf of the MLO. *See generally*,1A Mem. at 9-26. But the clerical and administrative work of shuttling information between a borrower and an MLO is ***not*** licensable. *Id.* at 2-5.

Fundamentally, Defendants continue to ignore the well-defined separation of duties between HLCs and MLOs at 1st Alliance. As established in testimony at the administrative hearing, all of the activities that Defendants are concerned about, including taking applications, offering terms, and setting interest rates, were performed by MLOs, with HLCs in a strictly intake and administrative support capacity. *See, e.g.,* AR983:4-989:11; AR2238:21-2261:16. Defendants have never disputed that 1st Alliance's MLOs were licensed, well-trained, and good at their jobs. *See* AR990:4-991:14. Defendants attempt to blur the lines between these two distinct roles and pretend that HLCs did all the work. But that simply is not true, and is not what the evidence shows.

C. Alexander Cottone's False Testimony

The main disputed factual issue in this appeal is Defendants' reliance on the testimony of HLC Alexander Cottone. Contrary to the testimony of every other witness, Cottone testified that as an HLC he could and did "obtain all the information for the Form 1003" (Def. Br. at 8, 31) and that he could lock interest rates for customers (Def. Br. at 33 n. 10).[10] This testimony is

[10] Defendants also cite to the testimony of HLC Martin Murdock for the proposition that HLCs collected all application information, including property addresses. *See, e.g.,* Def. Br. at 6-7. But this is a mischaracterization of his testimony. *See* 1A Br. at 22 and n.19.

simply false, and the Commissioner's reliance upon it is "clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record" (§ 4-183(j)).

First, it is contrary to the documentary evidence and to the testimony of every other witness, including other HLCs. *See generally* 1A Br. at 10-18, 22-24.

Second, it is literally impossible given how 1st Alliance's computerized inquiry and Optimal Blue rate lock systems were set up. *See* 1A Br. at 10-11, 16-17; AR2224:7-22 (testimony of Rate-Lock Desk manager).

Third, Cottone's testimony about his supposed practices is contrary to his ***actual*** and ***documented*** course of conduct as an HLC. As discussed in 1st Alliance's appeal memorandum, Cottone was the HLC for the J.L. transaction. *See* 1A Mem., at Ex. A9. The Byte log for that transaction conclusively demonstrates that Cottone did not collect an address (*see id.* at Ex. A9 at ❸, ❹) or lock an interest rate (*see id.* at 16 n. 17). Cottone was also the HLC for a transaction with borrower N.C. During the initial intake call on November 27, 2017, N.C. volunteered that he had a specific property in mind, but did not give that property address. AR5524:1-10. Pursuant to 1st Alliance policy (and contrary to his hearing testimony), Cottone properly did ***not*** request the property address, but rather proceeded with the rest of the intake. *See generally* AR5524-5530. Licensed MLO Eric Ward then took N.C.'s application by phone on December 13, 2017. Ward identified himself as an MLO (AR5349:17-22) and walked through the ordinary steps for the company's application process (*see* 1A Mem. at 13-14). Specifically, ***MLO Ward*** verified the property address that N.C. had submitted to 1st Alliance for the first time as part of his purchase and sale agreement (AR5351:4-12). Towards the end of the call, ***MLO Ward*** disclosed an estimated 3.75% interest rate, which Ward explained was not yet locked in (AR5376:19-5378:17). Six days later, on December 19, 2017, ***MLO Ward*** spoke again with N.C.

to lock in the 3.75% interest rate on Optimal Blue. AR5384:23-5385:19. Accordingly, the record evidence demonstrates that even for transactions with which Cottone was personally involved, licensable activity was performed not by Cottone or any other HLC, but by a licensed MLO.[11]

In the face of all of the above evidence, Cottone's lone and uncorroborated testimony simply is not credible. The Commissioner's decision to favor that testimony over the vast preponderance of the other evidence was arbitrary, capricious and an abuse of discretion.

III. Defendants' Arguments Regarding Supervision Are Without Merit

In its appeal memorandum, 1st Alliance explained that Conn Gen. Stat. § 36a-498e(b)—the only statute the Commissioner claims was violated when 1st Alliance purportedly failed to supervise its HLCs—***postdates*** the activity in this case and thus ***cannot*** be the basis for liability. 1A Mem. at 26-27. Defendants ***completely ignore*** that fact, and simply continue to assert that 1st Alliance violated an at-the-time non-existent statute. *See generally* Def. Br. at 41-42.[12]

1st Alliance also explained that even if that statute applied, its terms are only violated if an alleged failure to supervise actually "resulted in conduct" that substantially violated the SAFE Act. Because HLCs did not violate the SAFE Act, any "failure to supervise" claim against 1st Alliance necessarily fails. *See* 1A Mem. at 27.

Moreover, contrary to Defendants' argument, 1st Alliance had a robust system of supervision. All activity at 1st Alliance was conducted under the auspices of 1st Alliance's own

[11] Even if Cottone (or another HLC) ***did*** perform licensable activities—and the evidence shows they did not—it would be ***that HLC*** who was legally responsible for the misconduct, not 1st Alliance as a company. "According to HUD," the federal agency responsible for enforcement of the SAFE Act, "the SAFE Act is ***not directed to entities***, large or small, ***but to individuals***." July 14, 2011, Correspondence from the United States Government Accountability Office to the Honorable Tim Johnson *et al*., at p. 4 of 6 (available at https://www.gao.gov/assets/gao-11-817r.pdf).

[12] As discussed in Part IX below, this arbitrary and capricious disregard for assessing whether 1st Alliance has actually violated any law has characterized the Department's conduct throughout these proceedings.

Nationwide Multistate Licensing System (NMLS) license number, #2819. This license number appears on every page of every Byte log (*see, e.g.,* BYTE 2548) and as the controlling "BranchNMLSID" for every loan in the aggregated database of all 667 applications taken at 1st Alliance during the relevant period (*see* AR7378-80 at final far right column). In its role as licensed Mortgage Lender and overall responsible party, 1st Alliance supervised all company operations through several different methods and multiple levels of oversight.

1. **IT Controls.** 1st Alliance supervised HLCs through technological limitations. HLCs were literally ***unable*** to take an application under the SAFE Act. 1A Mem. at 10-11, 13-14. HLCs also did not have access to 1st Alliance's rate lock and pricing technology, Optimal Blue. 1A Mem. at 16-17.

2. **Legal and Compliance Controls.** 1st Alliance's legal and compliance teams developed thorough and comprehensive written policies and procedures. *See* AR2366:20-2368:23. Among other relevant policies, the Company had an application policy (AR5746-47), a SAFE Act policy (AR6696-97), a quality control policy (AR6635-45), a social media policy (AR6198-99) and a cell phone policy (ARAR6194-95). The complete 245-page "Compliance Policies and Procedures" addresses almost every conceivable issue an HLC or other employee might face. *See* AR6472-6716.

3. **Progressive Discipline**. 1st Alliance would engage in progressive discipline of employees where problems were identified. *See* 1A Mem. at 28-29.

4. **Associate Vice Presidents of Production**. 1st Alliance employed two Associate Vice Presidents of Production and three Associate Vice Presidents of Sales. *See* AR3529-34 (employee list with positions). These individuals, several of whom were licensed, supervised sales activity under the auspices of 1st Alliance's NMLS ID.

5. **Qualified Individuals.** The company maintained three Qualified Individuals who worked directly in the company's call center, who had "supervisory authority over the lending activity" at 1st Alliance and were "responsible for the actions of" the company. § 36a-488(a)(1)(A)(i). These Qualified Individuals, who were members of company management, were licensed MLOs themselves, including Kevin St. Lawrence, who was licensed in Connecticut. *See* AR4279-91.

6. **Executive Vice Presidents of Sales.** Below the Production Qualifying Individual, 1st Alliance employed two licensed Executive Vice Presidents of Production who reported to both the COO and the licensed President of Loan Production. They managed the day-to-day activities of the company's sales managers, branch

managers, and Loan Processing managers (All AVP's). AR949:24-950:2. The EVPs of sales were also licensed.

7. **Branch Managers**. Below the EVPs, 1st Alliance retained three to five MLO-licensed Branch Managers who had "supervisory authority over" and was "responsible for" the actions of the call center. § 36a-488(a)(1)(A)(ii); *see*AR3529-34. Once again, the Branch Managers were licensed MLOs.

8. **MLOs**. MLOs performed three specific tasks (pre-qualifications, the taking of applications, and the offering and negotiation of terms), and, as such, did not formally "supervise" HLCs in terms of HR policies. However, MLOs did supervise HLCs in the HLCs' performance of clerical, information gathering, and support work as Lead Generators and Loan Processors with regard to the MLO's own duties. *See* 1A Mem. at 2-5, 15-17; *see also* AR2197:4-22, 2264:19-2265:8, 2269:25-2270:14.[13] If an HLC ***did*** ever offer and negotiate terms (and there is not a single example in the Order or Defendants' Brief of that happening), the MLO would discover such a transgression upon receiving the file.

9. **Loan Processors.** 1st Alliance employed dedicated Loan Processors to help shepherd files through the process. Loan Processors did not require their own licenses because they operated under the umbrella of 1st Alliance's own Mortgage Lender license. *See* 1A Mem. at 2-4. Dedicated Loan Processors would direct and supervise HLCs in their information gathering duties. *See* 1A Mem. at 15-16.

10. **Loan Underwriters.** As with Loan Processors, 1st Alliance employed Loan Underwriters who operated under the umbrella of 1st Alliance's Mortgage Lender license. Also as with Loan Processors, Underwriters would direct HLCs (and Loan Processors) in their clerical duties. *See* 1A Mem. at 15-16.

As one HLC explained, there were people "overseeing everything," and if direct supervisors "weren't available" there were "other resources [*i.e.*, supervisors] to speak to." AR2042:25-2044:2. Still other supervisors "would just monitor our pipelines and our interactivity" (and whom HLCs could also approach "if we had questions"). AR2044:3-18.

[13] In addition, the MLOs were themselves supervised in their duties: all the information collected and the terms calculated by the MLO would be tested again by both a processing unit and an underwriting unit. AR2192:20-2195:20.

Defendants' remaining arguments (Def. Br. at 41-42) merely repeat the Commissioner's findings, and 1st Alliance addresses those findings and arguments in its appeal memorandum (1A Mem. at 26-30).[14]

IV. Defendants' Arguments Regarding Aiding and Abetting Are Without Merit

Defendants' arguments regarding aiding and abetting liability (Def. Br. at 40-41) are without merit. Defendants rely heavily on Massey's 2017 audit report for the proposition company management was aware of supposed widespread misconduct among HLCs, but ignore her admission that she exaggerated her concerns in the text of that document, that the actual number of problematic interactions with customers were quite low, and that, in any event, the SAFE Act is filled with "grey areas." *See* 1A Mem. at 32 and Part II.A. above. They argue that 1st Alliance did not want to spend money getting licenses for all its HLCs, but there was no legal need to license those individuals given that HLCs were not performing licensable activities. *See* 1A Mem. at 1A Mem. at 27-28, 34. Defendants likewise complain about 1st Alliance's practice of offering sales incentives, but offer no authority that this common practice is illegal. *See id.* Defendants' concerns about 1st Alliances compensation structure (Def. Mem. at 19) likewise does not raise any legal concerns. *See* 1A Mem. at 1A Mem. at 27-28, 34. As with much of Defendants' brief, their "aiding and abetting" argument consists of policy preferences in search of a (non-existent) legal violation.

[14] For example, as the relevant timeline demonstrates (1A Mem. at Ex. A6), Defendants' argument that lack of supervision harmed borrower D.K. (Def. Br. at 14-15, 41) is incorrect. In fact, contrary to Defendants' argument, an MLO did review the borrower's file before issuing the prequalification letter. See 1A Mem. at 26. The prequalification letter specified that the commitment was subject to several conditions, including "further substantiation of income." *Id*. Upon obtaining further information from D.K., it turned out that his family income was not qualifying. *Id*.

V. Defendants' Arguments Regarding the Truth-in-Lending Act Are Without Merit

As Defendants admit, TILA's disclosure requirements come into play ***once an application has been taken***. *See* Def. Br. at 38-39. Defendants argue that TILA's requirements were triggered at the inquiry stage based upon their (wrong) conclusion that 1st Alliance "already had the necessary information for an 'application'" at that point. *Id.* But HLCs did not collect all of the information required for an application at the inquiry stage. Accordingly, 1st Alliance did ***not*** have the information necessary for an application ***until an MLO actually took an application***. And as a matter of company policy, 1st Alliance would not take an application until the consumer submitted a purchase and sale agreement (which the company's MLOs disclosed in writing within hours of initial contact; *see* AR6191). As a result, TILA disclosures were not triggered until after such submission (and the subsequent taking of an application). 1A Mem. at 35-37. Defendants may not think that was optimal public policy, but it fully complies with TILA.[15]

Moreover, this policy did not unduly hamper a borrower's opportunity to "shop around" for a better mortgage deal. The mortgage contingencies that are a routine part of purchase and sale agreements state that if a customer cannot get a mortgage on the terms stated in the agreement, the customer can back out with no consequences. *See, e.g.*, AR3476 ("Financing

[15] Even if 1st Alliance had the information necessary for a complete application at the intake stage—which it did not—it did not have a formal 1003 "application" under its application policy. *See* 1A Mem. at 1, 3, 7, 11-12, 23. Defendants cannot expand the formal statutory definition of "application" to include a prospective application. *See Bureau of Consumer Financial Protection v. Townstone Financial, Inc.*, No. 20-cv-4176, 2023 WL 1766484, at *3-11 (N.D. Ill. Feb. 3, 2023) (invalidating CFPB regulations that attempted to expand prohibitions regarding "applicants" under the Equal Credit Opportunity Act to prospective applicants as well).

Contingency" clause).[16] 1st Alliance's loan estimates were sent an average of five weeks before closing in the transactions highlighted by the Commissioner in his Order, and, indeed, consumers routinely chose other lenders. 1A Mem. at 37-38.

VI. Defendants' Arguments Regarding 1st Alliance's "Failure to Inform" Borrowers That HLCs Were Not Licensed Are Without Merit

Defendants' argument that 1st Alliance operated a "fraud or deceit" by failing to inform consumers that HLCs were not licensed (Def. Br. at 42-43) is without merit. Defendants assert that an HLC's licensure status would be material to a consumer in deciding whether to do business with 1st Alliance. Def. Br. at 42. But that would only be true if HLCs were engaged in licensable activity. Because HLCs did ***not*** perform licensable activity, there is no reason why a consumer would care one way or the other about whether the HLC had a license.

In any event, 1st Alliance's HLCs disclosed their job title to potential customers, including in their standardized email signatures and during phone conversations. *See* 1A Mem. at 17. Consumers were well aware of the difference between HLCs and (licensed) MLOs. *See id.* at 17-18. Neither of the exchanges highlighted by Defendants in their Brief (at 43) involve 1st Alliance or an HLC misleading a customer:

- First, Defendants point to a conversation between HLC Batherson and a prospective borrower in which the borrower asked whether Batherson was licensed in Colorado, and Batherson replied that ***1st Alliance*** was licensed in Colorado. Def. Br. at 43. Batherson's response was undisputedly true and was the only material licensure fact to the transaction, given Batherson's limited responsibilities as HLC. The consumer apparently was satisfied and did not ask any follow-up question.

- Second, Defendants point to an email in which a potential borrower told their insurance agent that "[t]he loan officer is: Ryan Batherson, Submission Coordinator."

[16] The N.C. transaction discussed in Part II.C. above further demonstrates this point. N.C. submitted a purchase and sale agreement with regard to a certain property and MLO Ward took an application regarding that property, as discussed above. But N.C. was not locked in or committed; indeed, N.C. found another property, and that original purchase was ultimately abandoned. MLO Ward took a second application on January 18, 2018, on a wholly different property. *See generally* AR5330-5348.

Def. Br. at 43. Given that the borrower used both titles, it is impossible to discern what their understanding was, and the Department opted not to call this borrower as a witness.[17] However, there is no dispute that Batherson always signed his emails as "Submission Coordinator" (*see* 1A Mem. at Ex. A5), as this borrower relayed to his agent.

Accordingly, Defendants' "failure to disclose" argument is baseless.[18]

VII. Defendants' Arguments Regarding 1st Alliance's "Failure to Cooperate" Are Without Merit

1st Alliance fully cooperated with the Department's 2018 audit wherever possible. 1A Mem. at 39. Defendants focus on a ***single*** dispute: 1st Alliance's inability to respond to an extraordinarily broad subpoena. Def. Br. at 43-45. But compliance with that subpoena was, as a practical matter, all but impossible. Producing documents would have required 1st Alliance to review over ***200,000*** individual emails for relevancy and privilege. *See* 1A Mem. at 40. In parallel FOIA proceedings brought by 1st Alliance's CEO against the Department, the Department admitted that merely reviewing documents numbering in the ***tens*** of thousands took it ***over 400 hours***. 1A Mem. at 41 n.34. Defendants argue that the Department offered to allow production on a rolling basis (Def. Br. at 43), but that was not a realistic compromise, as it still would have taken months, if not years, for 1st Alliance to complete its review given the volume of documents requested.

Perhaps recognizing the absurdity of their document demand, the Department chose not to try to enforce its subpoena before the court. The Department attempts to shift blame for its failure by arguing that 1st Alliance did not affirmatively move to quash. Def. Br. at 44-45. 1st Alliance may have had that ***option***, but it was not a required step. 1st Alliance had lodged its

[17] Indeed, the Department did not call ***any*** consumer witnesses, or otherwise attempt to establish actual consumer confusion. *See* 1A Mem. at 30, 34.

[18] As to the social media posts highlighted in Defendants' Brief (at 17-19, 43), *see* 1A Mem. at 30.

objection, and it was the Department's obligation to exercise its rights under § 36a-17(e) if it felt penalties for noncompliance were warranted (which the presiding court could have imposed under § 36a-17(f)). It would be fundamentally unfair to allow Defendants to refuse to seek enforcement of the subpoena, and then punish 1st Alliance for validly objecting to the Department's impossible demands. Defendants' reliance on *Commissioner, Dept. of Ins. v. Freedom of Information Commission*, No. CV176039096S, 2019 WL 324883 (Conn. Super. Jun 12, 2019) (Def. Br. 44-45), is misplaced. In that case, the court ***reversed*** a ***$500*** penalty imposed for failure to produce documents in response to an administrative subpoena, holding that the commissioner's imposition was an "abuse of discretion" where the penalized party acted "in good faith…in refusing to submit the requested information." Here, the Commissioner's imposition of ***license revocation*** and a ***$750,000 penalty*** based at least in part on this purported violation is equally an "abuse of discretion."[19]

VIII. Defendants' Arguments Regarding the Penalties Imposed by the Commissioner Are Without Merit

Contrary to Defendants' arguments (Def. Br. at 45-47), the penalties imposed by the Commissioner are illegal and improper. *See generally* 1A Mem. at 46-50. Among other failings, the Department's failure to this day to articulate the specific conduct they believe requires licensure under the SAFE Act is a gross violation of 1st Alliance's due process rights, as well as those of other participants in the mortgage industry. *See* Part II.A. above.

[19] 1st Alliance admits that, as Defendants note (Def. Br. at 45), Mr. DiIorio believes that the Department has engaged in an "abuse of power," that the Department's charges were "bogus," that the auditors' tactics and refusal to consider evidence were improper (as did Briana Massey), and that 1st Alliance should "be aggressive" in fighting any claim of wrongdoing. *See* 1A Mem. at 42-46 and Part IX below. But regardless of Mr. DiIorio's personal opinion, 1st Alliance gave full cooperation to the Department's investigation wherever feasible (1A Mem. at 39). Defendants point to no other instance where they claim 1st Alliance failed to cooperate other than with regard to the subpoena.

As to license revocation specifically, the parties agree that 1st Alliance's license was revoked pursuant to a parallel proceeding, a year and a half before the Commissioner issued his order in this case. *See* Def. Br. at 45-46; 1A Mem. at 46-47. However, that does not render the issue "moot" (Def. Br. at 46). The difference between revocation for what at most was a technical failure to maintain a bond (as in the parallel proceeding) and for alleged violations of the SAFE Act (as in this action) can be material in connection with 1st Alliance's principals' future endeavors. Accordingly, this Court should reverse the Commissioner's order revoking 1st Alliance's license in these proceedings.

As to the exorbitant $750,000 penalty, Defendants argue that the Commissioner's finding of "eight general statutory" violations is sufficiently specific to justify the sanction. Def. Br. at 46. But should the Court agree with 1st Alliance in this appeal on some issues but uphold the Commissioner's finding of violation as to others, there is no way for the Court to assess what portion of the penalty should be upheld. The Commissioner's failure to specify the penalty imposed for each statutory violation makes it impossible for this Court to assess a meaningful review of the overall amount. *See* 1A Mem. at 48-49.[20]

Finally, Defendants' reliance on *Pet v. Dep't of Health Services*, 228 Conn. 651 (1994), for the proposition that the Commissioner's exorbitant fine cannot be unconstitutionally excessive (Def. Br. at 47) is puzzling. As Defendants acknowledge, *Pet* merely says that an administrative penalty generally cannot be challenged "***unless*** the discretion [afforded to the Commissioner] has been abused." *Id.* at 677 (emphasis added). Such abuse of discretion is

[20] Should the Court remand to the Commissioner for a breakdown of the $750,000 penalty, it would plainly be improper for the Commissioner to ***increase*** the overall penalty on remand, as Defendants posit could occur (Def. Br. at 46-47). Not only would such post-hoc modification violate 1st Alliance's Constitutional and UAPA rights, but would plainly be ample evidence of the Commissioner's animus against 1st Alliance for protecting its rights.

exactly what 1st Alliance demonstrated happened here through both Defendants' general bias and their refusal to link the penalties imposed to specific violations.

IX. The Commissioner and Department Were and Are Biased Against 1st Alliance

As this Court has observed, "[a]chieving justice requires both a just result and the utilization of a process which is substantively just…. Although they operate within our adversary system, [regulators'] position as public servants, and the authority granted to them, require that they rise above common adversaries such that their goal is not merely to win but to achieve overall justice, with all that entails." [Dkt. No. 117.10] at p. 1.

Here, 1st Alliance respectfully submits that Defendants' bias has been plain and evident from the start. *See generally* 1A Mem. at 42-46. For example, the 2018 audit contained multiple irregularities, including non-standard audit tactics and refusal to consider relevant evidence. 1A Mem. at 43. Defendants then refused any settlement that did not include a gag order, and sought to bar 1st Alliance from defending its practices in ***other*** states ***where the Defendant Department has no jurisdiction***. 1A Mem. at 44-46.[21] Notably, after refusing to settle with 1st Alliance without a gag clause, Defendants proceeded to abandon the gag clause requirement in future settlements with other regulated entities. 1A Mem. at 46 and n.39. Defendants' disparate treatment of 1st Alliance with regard to the gag clause, and their attempt to exert their influence outside of the Department's Connecticut jurisdiction, demonstrates Defendants' bias.[22]

[21] On information and belief, Defendants were reaching out to several of those other states to encourage them to bring action against 1st Alliance at the same time as they were seeking to impose a nationwide gag order on 1st Alliance to prevent it from defending itself in those jurisdictions.

[22] Defendants' reliance on *SEC v. Romeril*, 15 F.4th 166 (2d Cir 2021), is misplaced. 1st Alliance is not challenging the ***legality*** of gag orders in this proceeding (although plenty of federal judges ***do*** question their Constitutionality; *see, e.g., SEC v. Moraes,* Fed. Sec. L. Rep. ¶ 101492, 2022 WL 17550619 (S.D.N.Y. Oct. 28, 2022)). Moreover, Defendants' gag order went even further the SEC's gag order. The SEC's gag order only bars "public" statements refuting the SEC's claims. *See Romeril*, 15 F.4th at 170*;*

The Notice of Intent to Revoke Mortgage Lender License that launched these administrative proceedings on December 5, 2018, evidences that Defendants have been acting in a suspect fashion from the very start of this process. The Notice claimed that 1st Alliance had been selected for the 2018 audit based on a "whistleblower" complaint. But Defendants have refused to disclose the whistleblower's identity, and the Department auditor struggled in his testimony as to whether 1st Alliance was selected for audit based simply on the time since the previous audit or due to a whistleblower complaint, or whether there even was a whistleblower at all. AR1256:7-1259:18. Given this murky testimony, 1st Alliance has reasonable concerns as to whether Defendants improperly targeted 1st Alliance—and are now trying to hide that fact.

Defendants' argument that this Court has already "rejected" any claim of bias when it denied 1st Alliance's motion to depose Stacey Valerio [Dkt. No. 110.00] is incorrect. The Court simply concluded that 1st Alliance had not justified opening the record to include Ms. Valerio's testimony. *See* [Dkt. No. 110.20] at p. 3 ("the plaintiff has failed to make a showing that it would be necessary to resort to evidence outside the record"). However, the Court did not conclude that no bias existed, or bar 1st Alliance from using evidence already ***in*** the record to demonstrate that bias.

X. Conclusion

For all of the reasons set forth in 1st Alliance's appeal memorandum and above in this Reply, the Commissioner's decision to penalize 1st Alliance was arbitrary and capricious. The lack of due process afforded to 1st Alliance and the constitutionally excessive sanctions imposed by the Commissioner are of a piece with the demand for a gag order that sought to prohibit 1st

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Moraes, 2022 WL 17550619. Defendants' gag order also expressly bars 1st Alliance from defending itself "***in regulatory filings***." *See* 1A Mem. at 45 n. 37 (quoting AR4514) (emphasis added).

Alliance from defending itself in other jurisdictions and to prohibit the company from protesting Defendants' tactics. Defendants appear intent on ensuring by fiat and example that neither 1st Alliance nor any other company ever again employ 1st Alliance's business model, regardless of its legality. Defendants imposed their will by bypassing the legislative and regulatory rule-making processes and by abusing their muscle under the Connecticut Administrative Procedures Act—pursuant to which the agency itself is both prosecutor and judge (and executioner)—to render judicial relief nearly fruitless. By imposing license revocation (the corporate death sentence) on 1st Alliance and then imposing a massive fine on its corpse, the Commissioner is sending a signal to other companies about questioning his power. This Court should disallow Defendants' abusive conduct and reverse those penalties pursuant to §§ 4-183(j) & (k).

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing memorandum was sent on this March 8, 2023, to the Office of the Attorney General by email, as follows:

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/s/ Seth R. Klein
Seth R. Klein